Supreme Court, U.S.
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No. 04-593

In the
Supreme Court of the United States

DOMINO'S PIZZA, LLC; DOMINO'S PIZZA, INC.; and DEBBIE PEAR

Petitioners,

v.

JOHN MCDONALD,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF AMICUS CURIAE OF PACIFIC LEGAL FOUNDATION IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

In the absence of a contractual relationship with the defendant, are allegations of personal injuries alone sufficient to confer standing on a plaintiff pursuant to 42 U.S.C. § 1981?

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INTEREST OF AMICUS CURIAE[1]

Pacific Legal Foundation (PLF) is the largest and most experienced nonprofit public interest law foundation of its kind in America. Litigating nationwide since 1973, PLF provides a voice in the courts for thousands of Americans who believe in limited government, private property rights, individual freedoms, and free enterprise. PLF attorneys actively engage in research and litigate over a broad spectrum of public interest issues nationwide. PLF submits this brief because it believes its public policy perspective and litigation experience will provide a valuable viewpoint. PLF has participated in other cases before this Court, including *Jackson v. Birmingham Board of Education*, 125 S. Ct. 1497 (2005); *Elk Grove Unified Sch. District v. Newdow*, 542 U. S. 1 (2004); and *Lujan v. National Wildlife Federation*, 497 U.S. 871 (1990).

SUMMARY OF THE ARGUMENT

As a third party to the contracts between Domino's and JWM Investments, McDonald does not have a cause of action for personal injuries under 42 U.S.C. § 1981 for two reasons. First, the plain language of § 1981 protects only parties who have a potential or actual contractual relationship. Congress intended to limit the application of § 1981 to those who have the right to make or enforce the terms of the contract.

Second, as a matter of policy, courts should not disturb the contractual expectations of parties. As the owner of the contracting corporation, McDonald does not have his own

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[1] Pursuant to this Court's Rule 37.3 (a), all parties have consented to the filing of this brief. Letters evidencing such consent have been filed with the Clerk of the Court.

Pursuant to Rule 37.6, Amicus Curiae affirms that no counsel for any party authored this brief in whole or in part and that no person or entity made a monetary contribution specifically for the preparation or submission of this brief.

contract with Domino's, nor is McDonald an intended third party beneficiary of the contracts between JWM Investments and Domino's. Expanding the liability of Domino's to include McDonald's claims under § 1981 increases the amount of uncertainty involved in the formation of contracts and would have a negative economic impact on small businesses.

ARGUMENT

I

CONGRESS INTENDED TO LIMIT THE APPLICATION OF § 1981 TO THE CONTRACTING PARTIES

Title 42 U.S.C. § 1981 was originally enacted as § 1 of the 1866 Civil Rights Act and provides the right to "make and enforce contracts" without racial discrimination. "The principal object of the legislation was to eradicate the Black Codes, laws enacted by Southern legislatures imposing a range of civil disabilities on freedmen." *General Building Contractors Assn. v. Pennsylvania*, 458 U.S. 375, 386 (1982). The central theme of § 1981 is "to proscribe discrimination in the making or enforcement of contracts against, or in favor of, any race." *McDonald v. Santa Fe Trail Transportation Co.*, 427 U.S. 273, 295 (1976). Congressman Windom described the rights contained in § 1981 as securing "to a poor, weak class of laborers the right to make contracts for their labor, the power to enforce the payment of their wages, and the means of holding and enjoying the proceeds of their toil." Cong. Globe, 39th Cong., 1st Sess., 1159 (1866) (statement of Rep. Windom). Representative Lawrence stated: "It is idle to say that a citizen shall have the right to life, yet to deny him the right to labor, whereby he alone can live. It is a mockery to say that a citizen may have a right to live, and yet deny him the right to make a contract to secure the privilege and the rewards of labor." *Id.* at 1833.

In 1991, Congress amended § 1981 to define expressly the meaning of "to make and enforce contracts." 42 U.S.C. § 1981 (b). The purpose of the amendment was to overturn *Patterson v. McLean Credit Union*, 491 U.S. 164 (1989),[2] by establishing that § 1981 prohibits discrimination during the making, enforcement, *and performance* of all contracts. 137 Cong. Rec. S15472-01 (1991). The amendment provides "a remedy for any act of intentional discrimination committed in the making or the performance of a contract." *Id.* This includes "the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship." 42 U.S.C. § 1981(b). Although contracting parties may give a third party enforcement rights under a contract that gives rise to a § 1981 cause of action, the third party must prove the contracting parties' intent to bestow such rights in his favor; the purpose of the contract must impose an obligation on one of the contracting parties in favor of the third party. *Deckard v. General Motors Corp.*, 307 F.3d 556, 561 (7th Cir. 2002); *Reisenfeld & Co. v. Network Group, Inc.*, 277 F.3d 856, 863 (6th Cir. 2002). Thus, Congress intended relief to focus on the potential or actual existence of a contractual relationship between the parties.

Most courts have also found that relief under § 1981 depends on the existence of a contractual relationship. The Seventh Circuit explained that § 1981 "protects the right to enter into and preserve a contractual relationship, period. Moreover, there is nothing in section 1981's language

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[2] In *McLean*, a black former employee of a credit union brought a § 1981 suit against the credit union, claiming it harassed her, failed to promote her, and discharged her because of race. The United States Supreme Court held, *inter alia*, that racial harassment in the course of employment was not actionable under § 1981, which covered only conduct at the initial formation of a contract and conduct that impairs the right to enforce contractual obligations through the legal process. *Id.* at 179-80.

suggesting that Congress meant to stretch standing to the limits of Article III." *Kyles v. J.K. Guardian Security Services, Inc.*, 222 F.3d 289, 303 (7th Cir. 2000). *See also, Danco, Inc. v. Wal-Mart Stores, Inc.*, 178 F.3d 8, 14 (1st Cir. 1999) (finding that the same statutory language in § 1981 that provides a claim to the corporation contracting with the Defendant, precludes such a claim by the Plaintiff, the owner of the corporation, unless he also had a contract with the Defendant); *Bellows v. Amoco Oil Co.*, 118 F.3d 268, 276 (5th Cir. 1997) (explaining that because the Plaintiff's claim against the Defendant was merely derivative of the contracting corporation's cause of action, the Plaintiff had no individual § 1981 claim against the Defendant); *The Guides, Ltd. v. The Yarmouth Group Prop. Mgmt., Inc.*, 295 F.3d 1065, 1072-73 (10th Cir. 2002) (stating that the Plaintiff's "claim is derivative of that of [her corporation] and she does not have standing to sue on her own behalf [under § 1981]").

The plain language of § 1981 does not provide an incidental third-party the right to sue for injuries that are merely derivative of those rights that could be enforced by a party to the contract. Thus, it is the parties to a contract that are protected by § 1981; the intent of the parties to the contract is where the statute's protections should begin and end. Accordingly, this Court must dismiss McDonald's third party claim for personal injuries under the contract between JWM Investments and Domino's.

II

AN EXPANSION OF LIABILITY TO THIRD PARTIES UPSETS THE SANCTITY OF CONTRACTUAL EXPECTATIONS

McDonald does not have an individual contractual relationship with Domino's. A general principle of contract law limits the right to enforce contracts by providing that "a contract is only intended for the benefit of those who made it."

German Alliance Ins. Co. v. Home Water Supply Co., 226 U.S. 220, 230 (1912). Lacking any contractual relationship with Domino's, McDonald seeks to leverage his position as sole shareholder of JWM Investments into an intended third-party beneficiary of JWM's contract. But the provision in contract law allowing suits by third party beneficiaries applies only when the contract is made expressly for the benefit of the third party, not when the third party is incidentally benefitted. *Id. Elizabeth E. v. ADT Security Systems West, Inc.*, 839 P.2d 1308, 1311 (Nev. 1992); 17A Am. Jur. 2d *Contracts* § 447 (2005). The predictability of contracting and assessing potential liability is greatly diminished by a ruling that grants an incidental third party to a contract the right to sue under a statute protecting the right to contract free from discrimination, and business costs consequently rise. *See* Juliet P. Kostritsky, *Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 Hastings L.J. 621, 681 (1993) (explaining that when parties negotiate "in a state of uncertainty, the promisee who perceives a risk of bearing uncompensable reliance cost will insist on more favorable terms to offset those costs and risks"); Orna S. Paglin, *Criteria for Recognition of Third Party Beneficiaries' Rights*, 24 New Eng. L. Rev. 63, 105-111 (1989) (arguing for the use of economic criteria in the recognition of a third party's right to enforce a contract—*e.g.*, whether an award of relief to the third party might be burdensome on a promisor who did not foresee the possibility of being sued by the third party); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261, 265-67 (1985) (discussing the importance of adhering to the intent of the parties because reliability is the central concern of the contractual process).

A. McDonald Is Not a Party to the Contract

McDonald is attempting to disregard the corporate entity he created, and use the corporate form both as a shield and sword at his will. A corporation and its shareholders are distinct parties, with distinct rights and obligations under the law. *Dole Food Co. v. Patrickson*, 538 U.S. 468 (2003); *see also* 18 Am. Jur. 2d *Corporations* § 44 (2005) ("The basic purpose of incorporation is to create a distinct legal entity, with legal rights, obligations, powers, and privileges different from those of the natural individuals who created it, own it, or whom it employs."). JWM Investments has already settled its claim with Domino's. In his complaint, McDonald characterizes JWM Investments as his alter-ego. For example, McDonald's first cause of action states that "McDonald acting for JWM had contracts with Domino's, which contained all of the essential elements of a valid contract . . . ." Petition Appendix at 15. (Pet. App.) Later McDonald states: "McDonald accepted that offer by JWM's construction of the restaurants . . . ." Pet. App. at 15. The complaint continues, "McDonald's performance through JWM of services for Domino's served as consideration for Domino's promise to pay him for his services." Pet. App. at 15. "Domino's promise to lease from McDonald the completed restaurants served as consideration for his performance under the contract." Pet. App. at 16. McDonald is trying to blur the line between himself and his company to bring his individual claim under § 1981. A corporation is a legal construct. It exists on paper as a means of organizing a business. But no piece of paper can sign a lease or construct a restaurant. It takes a person to sign a document; it takes laborers to construct a building and install fixtures. The fact that people are necessary to implement the goals of a corporation does not mean that these people *are* the corporation or vice versa. Thus, a change in the identity of corporate shareholders does not void contracts made in the name of the corporation. *Morrissey v. Commissioner of Internal Revenue*,

296 U.S. 344, 358 (1935); Daniel J. H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. Cal. L. Rev. 1021, 1082 (1996) ("[S]tocks are permanent investments in the corporation regardless of the constant changes in the identity of the shareholders.").

By organizing a corporation, McDonald is subject to the disadvantages as well as the advantages afforded by state and federal law to corporations. For example, McDonald benefits from limited liability, which means that he is not personally liable for more than he has invested in the corporation. Nev. Rev. Stat. 78.747 (2001); Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 89-90 (1985) ("The rule of limited liability means that the investors in the corporation are not liable for more than the amount they invest."). McDonald cannot incorporate his business and then ignore the corporate fiction in an attempt to recover individually under § 1981. Because McDonald and his corporation are distinct entities, McDonald is not a party to the contract between JWM Investments and Domino's and, as shown below, can claim no preferred status to demand its enforcement.

B. McDonald Is Not an Intended Beneficiary of the Contract Between JWM Investments and Domino's

Section 1981 confers upon all persons the same right to make contracts, but only parties to the contract have the right to enforce them. Occasionally, enforcement by third parties carries out the intent of the parties to a contract. A third party may enforce a contract by demonstrating that the intent of the parties is to legally benefit him, but absent third-party beneficiary status, the third party has no standing to sue under § 1981. *E.g.*, *Randle v. LaSalle Telecomms., Inc.*, 697 F. Supp. 1474, 1481 (N.D. Ill. 1988), *aff'd*, 876 F.2d 563 (7th Cir. 1989) (black employees of minority marketing company did not have

standing to assert § 1981 claim that cable company breached its contract to assign white neighborhoods to the marketing company, since contract was between cable company and marketing company, and employees did not demonstrate third-party beneficiary status); *see also* 45C Am. Jur. 2d *Job Discrimination* § 2111 (May 2005) ("[O]nly the parties to a contract, or third-party beneficiaries of a contract, have standing under § 1981 to allege denial of the right to make and enforce contracts."). Courts often distinguish "intended" third party beneficiaries, who can sue under the contract, from "incidental" third party beneficiaries, who cannot, by determining whether the contracting parties intended to confer enforcement rights on the third party. Restatement (Second) of *Contracts* (1981) §§ 302, 304; Jean Fleming Powers, *Expanded Liability and the Intent Requirement in Third Party Beneficiary Contracts*, 1993 Utah L. Rev. 67, 67 (1993) ("Third party beneficiary standing is now an accepted part of American law, with 'intent to benefit' generally recognized as the determinative element in questions of standing.").

Allowing third parties to enforce contracts often conflicts with the ability of contracting parties to create value through exchange and to make reliable plans, two of the primary purposes for enforcing contracts. Melvin A. Eisenberg, *Third-Party Beneficiaries*, 92 Colum. L. Rev. 1358, 1374 (1992); Robert Cooter & Melvin A. Eisenberg, *Damages for Breach of Contract*, 73 Cal. L. Rev. 1434, 1459-64 (1985); Anthony T. Kronman & Richard A. Posner, The Economics of Contract Law 1-2 (Little, Brown & Co. 1979). An example from the Restatement illustrates this situation. B contracts with A to buy a new car manufactured by C. C is an incidental beneficiary, even though the promise can only be performed if money is paid to C. Restatement (Second) of *Contracts* (1981) § 302 illus. 17. Thus, if B breaches the contract and buys a car from D instead, C should not be able to sue B for its lost profits on the sale of the car.

Like car manufacturer C in the Restatement example, who does not get paid unless A and B perform their contract, McDonald is an incidental beneficiary who was injured because Domino's and/or JWM allegedly did not perform on their contracts. McDonald cannot enforce the contracts or sue Domino's for damages because Domino's and JWM did not intend to benefit McDonald by entering into the contracts. McDonald's company, JWM Investments, has the right to enforce the terms of the contracts with Domino's and to collect damages for any breach of contract. And, in fact, JWM did settle its claims with Domino's. Section 1981 provides an equal right for all people to make and enforce contracts irrespective of race, but McDonald did not personally exercise that right. Therefore, JWM is the party protected under § 1981, and Domino's had no reason to expect that McDonald would be able to sue under § 1981, or any other statute, based on its contracts with JWM Investments.

C. Expanding § 1981 Liability to Include an Incidental Third Party Beneficiary Produces Uncertainty in Contracting and Negatively Impacts Economic Development

Each party to a contract is entitled to know the scope of his or her obligations thereunder. In Nevada, contracts must be interpreted to "'effectuate the intent of the parties, which may be determined in light of the surrounding circumstances if not clear from the contract itself . . . .'" *NGA #2 Ltd. Liability Co. v. Rains*, 946 P.2d 163, 167 (Nev. 1997) (quoting *Davis v. Nev. Nat'l. Bank*, 737 P.2d 503, 505 (Nev. 1987)). This allows parties to enter into contractual arrangements with the confidence that they will not subsequently find themselves legally bound to unknown or unanticipated obligations. *Grigerik v. Sharpe*, 721 A.2d 526, 536 (Conn. 1998). That necessarily includes the range of potential third persons to whom a party may be liable in case of breach. *Id.*

A ruling that grants McDonald the right to sue under § 1981 increases the unpredictability of contracting by imposing nonconsensual liability to a wider range of third parties.

> Rooting the range of potential third parties in the intention of both parties, rather than in the intent of just one of the parties, is a sensible way of minimizing the risk that a contracting party will be held liable to one whom he neither knew, nor legitimately could be held to know, would ultimately be his contract obligee.

Grigerick v. Sharpe 721 A.2d at 536. Paglin, *supra*, at 110 ("While a restrained use of [tort and equity] theories has some merit in the context of commercial transactions, their rampant use may turn a field of consensual liability into a field of imposed liability."). Unknown liability and ambiguity in contracts increase the cost of business. *See* O. Lee Reed, *Law, The Rule of Law, and Property: A Foundation for the Private Market and Business Study*, 38 Am. Bus. L.J. 441, 461 (2001) ("[K]nowledge of the formal legal effect of contract law facilitates the trust and certainty necessary to place one's resources under the control of strangers . . . . [and] substantially lowers the costs of transacting business."); Dick Thornburgh, *America's Civil Justice Dilemma: The Prospects for Reform*, 55 Md. L. Rev. 1074, 1077 (1996) ("[T]o remain competitive, manufacturers need as much stability in their costs as possible—including predictable liability costs . . . ."); *see also* Charles J. Goetz & Robert E. Scott, *supra* at 265-72; Richard A. Posner, Economic Analysis of Law 107 (Little, Brown & Co. 1992). For example, if public policy concerns or ambiguities in an insurance policy are resolved against the insurance company when settling claims, increased insurance costs are passed along to the insured through increased premiums and restricted coverage. *Id.* Susan M. Popik & Carol D. Quackenbos, *Reasonable Expectations After Thirty Years: A Failed Doctrine*, 5 Conn. Ins. L.J. 425, 431-32 (1998); *Allen v.*

Prudential Property & Casualty Insurance Co., 839 P.2d 798, 808 (Utah 1992). Similarly, the imposition of nonconsensual liability to a third party exposes the contracting parties to increased costs. Paglin, *supra*, 105-06. Imposing nonconsensual or unchosen liability produces the more lasting social effect of legal and economic uncertainty for parties who seek to make future contracts. *See* Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. Chi. L. Rev. 1461, 1489 (1989) ("[C]lear and objective rules—such as treating one's signature as assent to a contract—promote economic growth since they encourage long-term decisions and investments by giving economic actors confidence that they can predict how the state will use its coercive powers.").

If contracting parties run the risk of having liability imposed on them against their will, they will be more reluctant to engage in such business in the future. Allowing incidental third parties such as McDonald to sue for discrimination under § 1981 increases the likelihood that a party who contracts with a small business will be subject to nonconsensual liability; parties would not only face liability to the company allegedly discriminated against, but also to the company owner for his or her lost income and/or emotional distress. *See, e.g., Gomez v. Alexian Bros. Hospital of San Jose*, 698 F.2d 1019, 1022 n.2 (9th Cir. 1983) (explaining that even though a corporation's sole shareholder sued under § 1981 for interference with a contract proposal, the corporation would still have standing to claim damages for its own injuries). Imposing liability to a third party increases the cost of doing business and conflicts with the general rule that an owner cannot maintain a personal action against a third party for harm caused to the corporation. 19 Am. Jur. 2d *Corporations* § 1937 (2005); Paglin, *supra*, at 105.

CONCLUSION

For the foregoing reasons, the decision of the Ninth Circuit should be reversed.

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Respectfully submitted,

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